No. 11959

IN THE

United States
Court of Appeals

FOR THE NINTH CIRCUIT

INDEPENDENCE LEAD MINES COMPANY,
an Arizona Corporation,

Appellant,

vs.

ALMA R. KINGSBURY AND
OLGA MARQUARDT,

Appellees.

PETITION FOR REHEARING EN BANC

Upon Appeal from the District Court of the United States for the District of Idaho, Northern Division

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Appellant respectfully prays that this cause be reheard and reconsidered en banc, and prays for a reconsideration of the opinion filed herein February 28, 1949, by reason of the dissenting opinion likewise filed herein, and because of the following points in which the appellant believes that the court fell into substantial and serious error on the legal and factual issues involved and presented by appellant in this cause:

I.

The court erred in holding that the fraud charged and complained of in the petition was made an issue in the litigation and was concluded by the stipulated judgment against the appellant prior to the filing of the petition for vacating said judgment.

The record in this cause, and particularly the undisputed allegations of fact in the appellant's petition to reopen and vacate the judgment, indicate, in our opinion, that there never was a litigation of any issue between appellant and appellees which in law or equity could sustain the then president of the appellant, F. C. Keane, in generously handing over to the appellees every last single share of Clayton stock held in the treasury of the appellant and including all of the trust stock held for the benefit of common stockholders by reason of a dividend previously declared to them. It must be conceded that it was quite a considerable time after appellees commenced an action to compel the payment to them of dividend Clayton stock by the appellant (Tr. page 2, et seq.), that appellant's president, F. C. Keane, who was then acting illegally as president of the appellant corporation, filed any answer in the cause (Tr. pages 38-43, incl.). It appears that Keane, who was then acting as president of the appellant corporation, made no answer of any kind going to the merits of appellees' complaint until *almost one whole year had expired from the date of filing the complaint.* Within two months after Keane, illegally acting as president of the corporation, filed an answer in the cause, appellees amended their complaint (Tr. page 43), entered into a stipulation with Keane and appellant corporation (Tr. page 45), and entered a stipulated judgment against the appellant (Tr. page 48).

Within one month after appellees commenced their

action in June of 1945, they caused notice in writing to be sent to the Clayton Silver Mines Company and its officers at its office in Wallace, Idaho, to stop forthwith all further transfers of Clayton stock belonging to the Independence Lead Mines Company; and appellees threatened that if said Clayton Silver Mines Company did not comply with said notice, they, the appellees, would immediately bring injunction proceedings to prevent any further disposition or transfer of such stock (Tr. pages 72, 73). The record indicates that there were no further sales of Clayton Silver Mines stock by F. C. Keane for the personal account of F. C. Keane, who was acting as president, or at all, *after the year* 1945 (Tr. pages 97, 98, 99, 100). We think it obvious that appellees' notice to Clayton Silver Mines Company was definitely effective; that the Clayton Silver Mines Company did heed the notice; and that Keane was likewise informed or had knowledge of said notice and threat; because it does not appear that Keane made any further sales or transfers after the notice given in July of 1945 even though the appellant company still had in its treasury at the time of appellees' notice and threat of injunction the sum of approximately 170,000 *Clayton shares.* (In connection with the above, see Note 5, majority opinion, and reference Note 7, dissenting opinion.)

The record further discloses that all of these remaining 170,000 shares were retained by Keane until they were awarded to appellees here by stipulated judgment of appellees and the then acting president,

Keane. Keane at the time of appellees' notice and threat of injunction directed toward Clayton Silver Mines had misappropriated 218,000 shares of Clayton Silver Mines Company stock held and owned by appellant corporation, and it does not appear that after appellees' notice and threat a single share was further disposed of. Appellees got the balance. (In this connection, likewise see table and breakdown of Clayton stock held by Independence, in dissenting opinion.)

Keeping the above facts in mind, we turn to the appellant's petition to vacate the judgment, entered on behalf of appellees with Keane, the defalcating alleged president of appellant. Such petition has already been the subject of discussion in the opinion of this court, and in the dissent. However, it is most important to point out that in analyzing the sequence of events related above, and keeping them in mind at all times along with the implications logically deducible from them, we find that the petition alleges that *appellees knew all about Keane's misappropriations* and dissipation of the company assets; that they knew the stipulated judgment entered into between them and Keane and the appellant would give them stock of other common stockholders already impressed with a trust character; and that they were definitely told by one John Sekulic, an emissary of the defalcating alleged president Keane, of all the facts and circumstances of the appellant corporation's situation and Keane's defalcations before they took the Clayton stock by the collusive judgment (Tr. pages 73, 74, et

seq.; Appendix pages 49, 50, 51, appellant's opening brief).

It therefore appears upon the undisputed facts in the petition, the truth of which are admitted by appellees' motion to dismiss directed against appellant's petition to reopen and vacate, that none of the fraud alleged in the petition to reopen and vacate was ever in issue or was ever litigated or concluded by the judgment in favor of the appellees. It would appear rather that the fraud and collusion determined the judgment and actively and positively prevented any proper real contest of any issues between the appellees and appellant. Therefore, inasmuch as the petition to reopen directly alleges by facts pleaded the participation of the appellees with the appellant in the fraud, the appellees, by reason of such participation, prevented any real contest or litigation on the merits of the controversy existing between appellees and appellant.

II.

The court erred in holding that Keane and the other directors were at least de facto officers in their relations with appellees.

The majority opinion in this case states as follows:

> "The petition avers that since the death of Marquardt in 1942 Independence had been under the control and domination of one Keane, its acting president; that Keane was currently disqualified to act as an officer because no longer a stock-

holder; and that the two other directors serving with and appointed by Keane were not stockholders, hence were also disqualified from acting. No stockholders meeting, it is said, had been held for eight years. It is averred that appellees, well knowing these facts, dealt with Keane in the settlement of their suit. *From the recitals of the petition as a whole, however, it is plain that Keane and the other directors were at least de facto officers.* Cf. Fletcher, Cyc. Corp., Vol. 2, Ch. 11, paragraphs 372-390. Keane was and for years had been in open and unchallenged possession of the office, discharging its duties under color of authority and with the acquiescence of the generality of stockholders. The latter appear to have recognized his authority to act for the corporation; and there is no allegation that they themselves were unaware of the true nature or infirmities of his tenure. The very dividend from which this litigation stemmed had been declared and was in process of distribution by Keane and his associates acting as officers and directors. The common stockholders had sought the dividend at their hands, recognized their authority to declare it, and claimed and accepted its fruits. We think Independence, speaking here ostensibly for the common stockholders, is in no position to challenge Keane's official status." (Italics supplied.)

It appears from the above that the court approves the position taken by appellees in their brief (see appellees' brief, pages 29-32, incl.) and it holds, furthermore, that the Independence Lead Mines Company speaking for and on behalf of the common stockholders is in no position to challenge Keane's official status. It can be conceded that generally many of the common stockholders were under the impression that Keane

was the legally elected president of the appellant corporation; and that Keane discharged his duties under color of authority and with the acquiescence of many of the stockholders. However, the record indicates that defendant Keane had not been entirely in open and unchallenged possession of the office (Tr. page 86).

Assuming, however, the majority opinion's statement as it respected Keane's relationship to many of the stockholders, it does not follow that appellees here who dealt with Keane, *knowing in fact that he was not even an officer de jure of the appellant corporation,* are free from liability to appellant corporation and its common stockholders for the Clayton Silver Mines Company stock and money which they received from the corporation as a result of a collusive, fraudulent, stipulated judgment.

The reason for the de facto doctrine has been stated as follows:

> "The reason for the rule was also well stated by Justice Clopton in Alabama as follows: 'The doctrine of the validity of the acts of officers de facto rests on public policy and justice. The official dealings of directors de facto with third persons are sustained as rightful and valid, on the ground of continuous acquiescence by the corporation, and suffering them to hold themselves out as having such authority; *thereby inducing others to deal with them in such capacity.* The theory of the doctrine of officers de facto, and the principles sustaining the validity of their official acts, are that, though wrongfully in office, yet exercising power and functions appertaining

> to such office, *justice and necessity require, for the protection and preservation of the rights and interests of third persons,* that their acts, within the scope of official authority and duty, shall be sustained.' " (Italics supplied.) (*Fletcher Cyclopedia Corporations, Perm. Ed., Vol.* 2, *Sec.* 384, *page* 163.)

It seems clear from the above that if the stockholders of a corporation, or the corporation by acquiescence allows officers to act and to deal with third persons, then the official dealings of those officers de facto are rightful and valid—*if, however,* such conduct of the corporation in its acquiescence *thereby induces others to deal with them in that capacity. That situation is not present here.* The petition to vacate the judgment alleges as facts admitted by appellees' motion to dismiss, that neither F. C. Keane nor two other so-called directors were in fact lawful directors of the appellant corporation (Tr. page 58); and the petition further alleges that appellees well knew these facts and well knew that there was no legal board of directors—*the appellees in fact knew that neither F. C. Keane nor the others were de jure officers* (Tr. pages 61, 70, 71, 85). There was no question of appellees being misled by Keane, the appellant, or appellant's stockholders, and there is no question involved concerning the protection of their rights, if any, as innocent third parties.

The rule applicable to appellees is as follows:

> "*Exception where person dealing with officers not misled.* The de facto rule will not be extended

to a case where a person dealing with alleged corporate officers is not misled, nor induced to believe that he is dealing with legal officers, but has knowledge that the person pretending to be an officer is not a de jure officer." (*Fletcher Cyclopedia Corporations, Perm. Ed., Vol.* 2, *Sec.* 385, *page* 163.)

A Washington case cited to the text, namely, *Grove-and Improvement Company vs. Farmers' Supply Com-pany,* 25 *Wash.* 344-346, 65 *Pac.* 529, states in part as ollows:

"The rule that third persons dealing with de facto officers of a corporation are protected in such dealings has no application. *The rule is designed for the protection of innocent third persons, who have dealt with such officers without knowledge of their true character.* But here the evidence offered tended to show that the manager of the respondent, who represented it in the making of the lease, was one of the persons intruding into the offices of the corporation which purported to execute the lease; and, as he had knowledge of the lack of authority of the intruders to represent the corporation, his knowledge must be imputed to the respondent." (Italics supplied.)

Also, it has been stated as follows:

"(4) But different considerations arise when the protection of third parties is not involved. A person clothed with apparent authority may be a de facto officer to the general public and to innocent third persons, but not such where his own rights are involved, *nor to those fully advised of his status,* nor as against one showing a prima facie right to an office he unlawfully withholds."

(*Carpenter vs. Clark,* 217 *Mich.* 63, 185 *N. W.* 868, 870.) (Italics supplied.)

The discussion and authority cited above determines that appellees did not acquire any right in the capacity of innocent parties that would clothe them with immunity from the present action of the appellant corporation, by reason of any dealings with de facto officers. Surely this appellant corporation has a right to prove, if it can, that the appellees dealt with individuals whom appellees knew had no legal right, or any right at all, to represent the appellant corporation.

III.

The court erred in holding that Keane's anxiety to prevent exposure was not a moving factor which induced the settlement.

We are obliged to assume, in view of the court's language (majority opinion), that it has held that Keane was re-acquiring substantial amounts of Clayton stock and that he made a public disclosure of the internal affairs of the Independence Lead Mines Company of his own irregularities as president. We feel obliged to assume also that the court is of the opinion that such disclosure by Keane was in the nature of a voluntary disclosure. The opinion of the court refers to the audit of the Independence Lead Mines Company in support of the above. In that connection, it is important to note the language in the petition of appellant set forth at page 89 of the transcript. (Reference is made to this complete proceeding (L. J. Hop-

ins and W. E. Cullen vs. Independence Lead Mines Company), and the same is included by reference in ne petition of appellant to vacate the judgment. See Tr. Page 61. Also see Tr. page 76.) The allegation to which reference is made, in the interest of convenience s set out herewith:

"XIV. For a long period of time the said Independence Lead Mines Company, and more particularly its President, F. C. Keane, for his own purposes and for the purpose of concealing the true condition of the affairs of said Company, neglected, failed and refused to file a report for the year 1943 and for the year 1944 and for the year 1945, as required by the rules and regulations of the Securities and Exchange Commission of the United States of America, and the rules and regulations of the Standard Stock Exchange of Spokane, Washington, and the rules and regulations of the Spokane Stock Exchange of Spokane, Washington, and the Secretary of the Securities and Exchange Commission *threatened to withdraw the said stock from its registration and from its trading on the Standard Stock Exchange and on the Spokane Stock Exchange unless such reports were filed, so that, on or about the 20th day of March,* 1947, *such reports were filed with an audit* made by L. J. Randall, a certified public accountant of the City of Wallace, Idaho, and which said reports were signed and filed by F. C. Keane as President of the Independence Lead Mines Company and by William Mullen, as Secretary of the said company, as accurate and correct reports in regard to the condition of the affairs of the Independence Lead Mines Company." (Italics supplied.)

It is likewise of interest to note that while the liti-

gation was pending between appellees and F. C. Keane and the appellant corporation in the years 1945 and 1946, that F. C. Keane made no disclosure of his own irregularities or of the internal affairs of the Independence Lead Mines Company for those years by the required reports to the Securities and Exchange Commission; the only disclosure Keane made was the surreptitious disclosure to the appellees shortly prior to the time that they secured their stipulated judgment against appellant corporation. It is our considered opinion that the one and only reason for the filing of the report by F. C. Keane in the year 1947 was the threat of the Securities and Exchange Commission to withdraw the Independence Lead Mines Company stock from trading. That action of the Commission would, of course, have exploded the affairs of F. C. Keane and the Independence Lead Mines Company in a more abrupt and resounding fashion than was possible by the institution of the receivership suit (Tr. page 82, et seq.). The above likewise indicates the direct relevancy of Keane's mismanagement and misdeeds to the acts of appellees, who, with knowledge of those facts, employed them in their own interest to prevent any trial of any issue then existing between appellees and appellant corporation. Likewise we submit to this Honorable Court that it would be almost impossible to prove direct threats against Keane, but the circumstances involved herein, when considered as a whole with all reasonable deductions and inferences from such circumstances, logically display the whole picture of the collusive judgment entered against

he appellant corporation. (Likewise in this regard ee Section IV below.)

IV.

The court erred in holding that there was no collusion or connivance engaged in by the appellees.

The court refers in its opinion to Restatement of he Law of Judgments, Section 122, comment 'e'. The atter part of the comment (see page 597, Restatement of the Law of Judgments) is as follows:

> "*Duress has the same effect as collusion and is similar to it.* It differs from collusion only in that there is a threat of a disagreeable alternative to the fiduciary if he does not act in violation of duty to the beneficiary instead of a benefit conferred upon or promised to him for such action." (Italics supplied.)

In view of the above, and keeping in mind the definition of 'connivance' (see appellant's reply brief, page 8), we suggest that duress and collusion were present, and are properly pleaded by appellant in the petition to vacate; and that such acts, charged as having been employed by appellees, are admitted by appellees' motion to dismiss. It must be remembered that appellees by stipulated judgment settled with appellant corporation, through Keane, and received from it, through Keane, all of its shares of Clayton Silver Mines Company stock, besides a sizeable amount of cash, in June of the year 1946 (Tr. pages 48, 49, 50), although prior to that time appellees knew by reason of the visit from Mr. Keane's emissary, John Sekulic

(Tr. pages 73, 74, 75), that Keane had misappropriated and taken unto himself 218,000 shares of Clayton Silver Mines Company stock belonging to the appellant corporation and its stockholders, including both of the appellees. Despite the knowledge of the misappropriations of Keane which were brought to the attention of the appellees prior to the stipulated judgment entered into with them by the appellant and with Keane, *they did nothing but take all of the balance of the Clayton Silver Mines Company stock remaining in the corporation treasury; they did not expose Keane; they did not investigate Keane; they did not call for a stockholders meeting; they did not try to remove Keane; they did not report their knowledge to any officer of the law or State's attorney; they did not take any step against Keane that would be consistent with the usual, ordinary action which would be taken by any stockholder against an officer of his corporation, who such stockholder knew to be corrupt, and who such stockholder knew had misappropriated practically all of the assets of the corporation for his own benefit.* Surely with this in mind, the only possible logical deduction to assume therefrom is *that appellees made no complaint or report of any kind, nor took any action of any kind, because of the payment to them in the stipulated judgment by Keane of the balance of all Clayton Silver Mines Company stock remaining in appellant corporation's treasury.* Duress of Keane seems apparent, for the facts indicate that after the settlement was made, no action of any kind was taken by these appellees, despite their knowledge of Keane's

deeds, *and it remained for the Securities and Exchange Commission to compel the disclosure of Keane's misdeeds to the other stockholders.* No disclosure whatsoever was made or attempted by appellees who had knowledge of the misdeeds and who profited in the settlement. Likewise, pertinent rules and important observations are made in respect to the above situation, in the following: Restatement of the Law of Judgments—Section 122, comment 'a', page 593; comment 'b', page 594, the latter part thereof which is as follows:

> "Likewise a person who has been harmed by a judgment obtained as the result of collusion between his representative and the representative of the other party is entitled to equitable relief upon discovery of the facts if other methods of relief are not then available."

Paragraph 'c' and illustrations, page 595; and paragraph 'd', page 596.

V.

The court likewise erred in not finding:

(a) That there is an obligation upon appellees to return the fruits of the stipulated judgment which they collusively acquired (see dissenting opinion);

(b) That appellees were in trustee relationship toward the stockholders entitled to the dividend (see dissenting opinion);

(c) That the appellees could have effectively sued

to prevent Keane from further stealing the corporate assets which gave value to the Class "A" common stock as well as all the other outstanding stock, or to remove Keane as president (see dissenting opinion).

CONCLUSION

We believe that this court by its opinion gives much more to the appellees than they even asked for when they commenced their action against F. C. Keane and appellant corporation in June of 1945. Appellees at that time were obviously seeking the Clayton Silver Mines Company stock remaining in the appellant's treasury for their own. In addition to securing all of that stock, appellees by their stipulated judgment secured the following judicial approval as to common Class "A," non-assessable stock, which appellees held:

> "That the common stock "Class A" of the defendant, Independence Lead Mines Company, including the 600,000 shares owned by the plaintiffs, as aforesaid, *has, possesses, and is entitled to the same and identical rights, privileges and benefits, share for share, as the common stock of the said Independence Lead Mines Company, the only difference or distinction between the common stock and the common stock "Class A" being that the latter is not subject to assessment.*" (Italics supplied.) (Tr. page 49,50.)

From the above, it can be seen that the issuable controversy, which is of the greatest importance to the appellant corporation and to all of its assessable common stockholders, has gone by default of Keane and

appellees, and as a result of their collusion and connivance in securing judicial approval.

It is indeed ironic that the decree mentions *"the only difference or distinction between common stock and the common stock Class "A" being that the latter is not subject to assessment."* In other words, the opinion says that common stock Class "A" is entitled to profits and dividends and all advantages of a financial nature accruing to any of the common stock held by common stockholders in many States of the United States; and the court is further judicially approving a situation where the common stockholders who have paid assessments on their stock to keep the corporation in business must continue to do so when assessments are levied; and the court is likewise judicially approving appellees' right to be free from any contribution, assessment, or payment to the corporation for any expense necessary to the corporation's life. At the present time appellees are given a lifetime moratorium on the payment of any stock obligation to the upkeep and life of this corporation. We submit to this Honorable Court, that this situation has fraudulently been brought into existence without even allowing the corporation to defend against the unjust claims of appellees, because of the connivance and collusion between appellees and Keane, the alleged president of the appellant corporation.

Furthermore, if the judgment of the court is to stand, we will be confronted with a situation in which the appellees may claim and possibly sustain their

right to vote their 600,000 shares of Class "A" common stock, something which they have never been able to do before they secured the stipulated judgment. The court's opinion constitutes judicial approval of the transfer of tremendous control to appellees without even allowing the corporation a voice to oppose the same. The right to vote stock is most valuable, and the control of the appellees by virtue of the validity of their 600,000 shares of common stock, Class "A," will be exercised in perpetual derogation of the right of the corporation to ever question its validity.

Therefore the appellant respectfully submits that a rehearing should be had and the decision be revised as to both law and fact, believing that a re-examination of the record made by the court after rehearing, wherein counsel may be able to assist the court better to examine the records, files and briefs in this cause, will result in a revision and reversal of the decision herein, and that a miscarriage of justice will occur if this case is not reversed.

Respectfully submitted,

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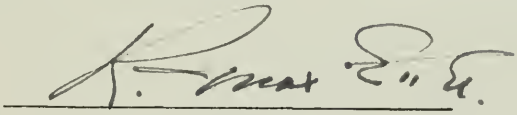
Attorneys for Appellant.

CERTIFICATE

I hereby certify that in my judgment the foregoing petition for rehearing is well founded, and that it is not interposed for delay.

Respectfully submitted,



R. MAX ETTER.